MICHAEL R. ENRIGHT
CHIEF OF STAFF

# STATE OF MARYLAND
## OFFICE OF THE GOVERNOR

July 23, 2009

Michael J. Wallace
Vice Chairman and COO
Constellation Energy Group, Inc.
Chairman, Unistar Nuclear Energy
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Dear Michael:

We are in receipt of your letter dated July 17, 2009 and agree that a direct dialogue is the best way to reach a satisfactory closing of the EDF transaction. Our role in this process remains unchanged. We need to understand the terms of the transaction, its benefits, and the implications for BGE. At the initiation of our review you appeared to understand our position. Mayo Shattuck wrote to Governor O'Malley on February 11, 2009 and said "I want to make clear that Constellation Energy agrees with your position that the State of Maryland and the ratepayers of Baltimore Gas and Electric need to better understand the implication for BGE if our proposed transaction with EDF Development is completed." Mr. Shattuck further committed that "Constellation will do everything it can to fully explain the proposed E.D.F. transaction and its many benefits to all concerned." Instead of fully honoring this commitment, Constellation has objected to the validity of our inquiry and taken all steps to limit the scope of a public interest review.

Notwithstanding this history, you state that "[t]he only potential for harm to BGE and its customers would arise not from the EDF transaction ...but rather from a failure to close the transaction." If the timing of the transaction is truly important, Constellation must focus on securing the PSC's approval, not on a protracted fight over their right to review the transaction. It may be that CEG's financial condition is so improved that a quick approval is no longer needed. Regardless, we will continue to respond constructively to your request for our involvement in negotiating a settlement with the PSC.

A meaningful discussion of all of the outstanding issues cannot take place without full transparency regarding CEG's financial position and the many substantive facts surrounding the EDF transaction. For example, you state that the development of a new nuclear plant at Calvert Cliffs will bring substantial value to Maryland and the State's ratepayers. However, despite repeated requests, we have not been able to get a public disclosure from CEG on the true projected cost of the expansion as well as the projected cost per kW of the new generation.

We have an obligation to understand the implications of the EDF transaction, and we cannot do this without the relevant information. The creation of a major new joint venture between Constellation and EDF would change the structure of your company. A major infusion of capital by EDF would permit Constellation to sustain some of the same hedging and energy trading activities that last year caused its near-bankruptcy, and the near-bankruptcy of BGE. We must avoid a situation where the benefits of the EDF transaction accrue only to the shareholders and/or management of Constellation, while the risks of future losses are borne by BGE and its ratepayers.

All stakeholders, whether they are on Wall Street or Main Street, must understand that the EDF transaction needs to be evaluated given the very different circumstance from those that were faced by BGE when the sale to MidAmerican was proposed. At the end of last year, Constellation was on the verge of insolvency. The entire company had been valued at $26.50/share, a total value of only $5.3 billion. The EDF deal would seem to create tremendous value for CEG – the put option to EDF of certain fossil assets alone has a market value that Wall Street analysts estimate in excess of $500 million. Even without the market value of the put, the deal, according to EDF, values CEG at $52/share – an implied value for CEG of $10.4 billion. Terminating the MidAmerican deal and entering into the agreement with EDF clearly made sense for the shareholders of Constellation. This was true in spite of the fact that CEG paid Berkshire Hathaway almost $1 billion in termination fees, a sum realized for just a few months of work. We need to be certain that the EDF transaction makes equal sense to BGE's other stakeholders.

It may seem simplistic but BGE and the ratepayers of Maryland have supported Constellation since its inception. Without the consistent earnings power and leverage provide by BGE, Constellation would not have been able to grow into a Fortune 200 company. We continue to be surprised by the current CEG proposal and the consistent lack of responsiveness from CEG's leadership. Constellation had no problem paying Mr. Buffett almost $1 billion for his nine weeks of effort. Yet when we seek a fair treatment for BGE's ratepayers in this transaction, CEG's management is indignant. We remain troubled that CEG regards the payment of a $1 billion termination fee to one of the country's leading investors as good business, but that it seems to regard a thorough review of the EDF transaction from the perspective of BGE's ratepayers as outrageous.

Now let me turn to the specific proposals contained in your letter:

I. Short and Long-Term Rates

Constellation's offer reiterates the limited concessions offered as a part of the MidAmerican transaction and includes not a dime in current rate reductions. We requested a one-time bill credit equal to a 10% annualized reduction for the average BGE rate payer. No credit was offered in your response. We requested that an increase in electricity or gas distribution rates be deferred until at least October 1, 2011 and any increase effective on that date to be capped at 2.5%. You offered to defer the next electricity and gas distribution rate increase until January 2010 and to cap an increase in the electricity rate at such date at 2.5%. No cap was offered for the gas distribution rates. We asked that the next electricity and gas distribution rate case be deferred until April 1, 2013 and that to cap any increase at such date at 2.5%. You offered to defer this case to January 2011 without any cap.

Our request that CEG contribute to the low-income energy assistance fund (Electric Universal Service Program) an amount equal to the amount charged to BGE ratepayers for the EUSP fund was not addressed.

As to long term rates, we suggested that Constellation provide 20% of the standard offer service residential load on a rate-regulated basis. You rejected this request. Let me be clear; we will not consider or support any settlement without concrete long term rate protection for our citizens.

II. Energy Conservation/"Green" Technologies

Constellation offers no substantive proposal to address energy conservation or green energy investments. The proposal can best be summarized as – "we will build it or invest in it if the ratepayers pay for it." In our proposal, we requested that CEG and EDF pay $200 million toward the expansion of the Smart Grid program in the BGE territory. Your counterproposal seeks to turn the $200 million commitment into additional guaranteed returns to your shareholders, paid for by BGE's ratepayers. You have turned a request to support BGE ratepayers into a program that is paid for by BGE ratepayers. This is not acceptable.

III. Ring-Fencing

I am pleased that both parties agree that robust ring fencing is necessary and in the public interest. However, a significant portion of your response to our ring fencing proposal is not just unacceptable, it is incorrect. You state that there are three provisions in our proposal for which "we are not aware of any instance in the United States where such extensive provisions were part of a ring-fencing plan to protect a regulated utility from the business activities of its parent company . . . ." You state that these are:

(i) The requirement that BGE have all independent directors.
(ii) The requirement that Constellation give up its right to name the BGE directors.
(iii) The minimum financial requirements, minimum equity ratio and ratings requirements for dividends.

First, we did not request that BGE have *all* independent directors. Our request was that BGE have a *majority* of independent directors. This is not an unusual request. For example, it was part of the conditions imposed in the 2008 ring fencing provisions implemented for Oncor Energy in connection with a private equity investment in its parent TXU (Texas Utilities).

Second, we did not request that Constellation give up its right to name the BGE directors. The proposal simply said that the Independent Directors are to be selected by mutual agreement between the State and CEG. CEG retains the unilateral right to select its slate of Directors and a specific approval right over each of the slate of Independent Directors recommended by the nominating committee.

Third, minimum financial requirements have been part of many ring fencing requirements including the following transactions:

1. Pacificorp/Mid American
2. Puget Sound Energy, and
3. Oncor.

The failure to adequately protect BGE from Constellation's commodities trading group almost resulted in BGE's failure. Now that EDF may provide additional capital to sustain part of your hedging and energy trading operations, we are even more concerned that the events of last September could happen again. The leadership and management team that contributed to the Company's performance this past year could remain at the helm and might continue to follow the speculative business practices which placed CEG and indeed BGE in jeopardy in the first place. In fact, in a recent financial report, Constellation noted that its current gross derivative position is just shy of $100 billion, nearly twenty times the Company's current stock market capitalization. Analysts were alarmed to see the size of this book and further noted that they were concerned by the lack of transparency and the limited liquidity that exists for the types of derivative contracts held by Constellation.

Clearly the best mechanism to protect the ratepayer from poor risk management or anything other than best practices evidenced by responsible corporate leadership is to properly and adequately ring fence BGE. Again, while our detailed review of your operations will address these concerns, we need to ensure that the past problems do not occur again.

IV. EXECUTIVE COMPENSATION

Constellation continues to misconstrue our concern about the compensation of your CEO. In your letter you state that the EDF transaction will give "BGE continued access to capital at reasonable rates, which in turn would allow BGE to provide reliable service at reasonable cost....[and]... to continue investing in energy infrastructure projects that will benefit Maryland." Your statements are correct.

Capital that is invested in Constellation SHOULD improve BGE's service, keep costs down and allow BGE to invest in energy infrastructure. For the same reason, capital that leaves Constellation and goes to pay bonuses to senior executives that are not correlated to performance, are harmful to BGE. This is exactly why we remain so concerned about the levels of compensation guaranteed by Constellation to your CEO.

In addition, compensation packages that are not tied to performance are troubling because they create dangerous incentives that can harm a company and deplete needed capital. We must understand the scope of these payments, how they were granted, and why they are not linked to company and individual performance. While the level of compensation may not expressly change with or without the EDF transaction, this compensation impacts the financial strength of BGE. If compensation to your CEO were based on legitimate performance metrics instead of mark to market results, there would be significant additional capital at Constellation that, as you stated in your letter, would help lower the cost of electricity service and could be invested in new energy infrastructure projects. Money is fungible.

We also do not agree with your statement that a change of control protects the "Company in the event of hostile corporate actions against it." Change of control agreements are put in place (in theory at least) to ensure that the CEO is free to negotiate a potential sale of the company (friendly or unfriendly) in the best interest of shareholders and not just to keep his job. They have no value as a deterrent, particularly in this case given the market value of Constellation relative to the payment. The reality of course is that the size of the payment is so out of line it serves only to let the CEO get rich at the expense of shareholders and ratepayers, who will indirectly pay for it since the purchaser needs to get that payment returned through future earnings.

Setting the level of compensation at Constellation is not our responsibility or our interest. However, when costs of executive compensation are allocated to BGE, and when, as a result, BGE cannot make needed capital improvements, such arrangements are of serious concern. S&P recently noted that it is now critical for "management to establish a credible track record under its revised strategic focus", one that focuses on exiting higher risk trading and places a greater emphasis on regulated operations. This is the performance that a Board should seek to reward. We must learn from our past mistakes and take proactive steps to insure the financial strength of BGE; we cannot do this without a careful review of past and current compensation arrangements.

I am prepared to work with Constellation and the Public Service Commission, who ultimately must approve the transaction, on a settlement that is satisfactory to all parties. Your recent efforts to overturn the PSC's ruling at the Circuit Court and your current appeal of that ruling are not helpful. This adversarial approach will only further delay and potentially frustrate a final determination that the transaction is in the public interest.

Regards,

Michael R. Enright

Michael R. Enright
Chief of Staff

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encl.
cc: Robert J. Lawless, Lead Director, Constellation Energy
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Jean Pierre Benque, EDF North America